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Economics Group

WELLS FARGO SECURITIES

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Federal Budget: The End of Tax Season

With preliminary data on federal revenues now available through the tax filing deadline, federal revenue growth remains on the soft side. We expect the deficit to widen in FY 2017 for the second consecutive year.

Federal Revenues Fail to Accelerate

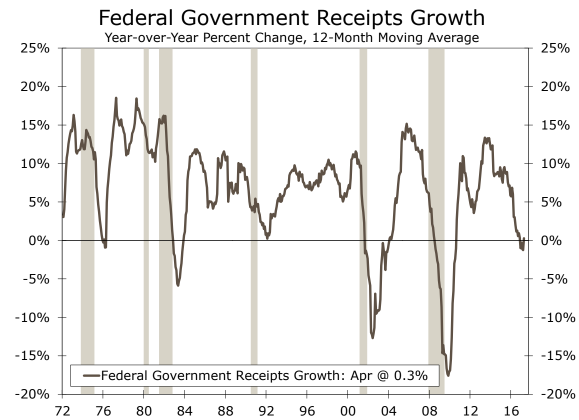
The Monthly Treasury Statement for the month of April offers the first comprehensive look at federal revenue trends post the filing deadline. Due to April collections, the federal government ran a surplus of $182.4 billion last month. However, as the top chart illustrates, federal revenue growth has been unusually slow for a non-recessionary period.

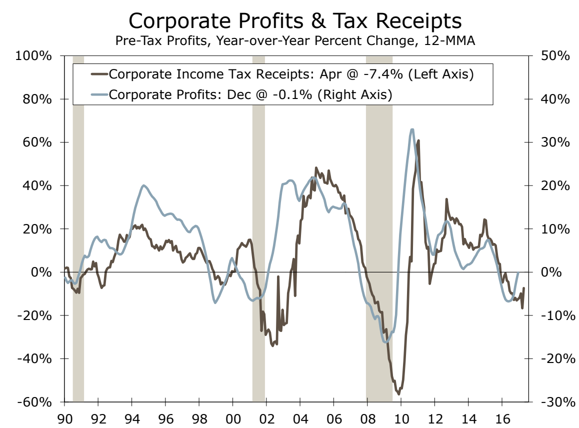
A few factors account for this slowdown. Some are one-off in nature, such as the large one-time payment at the end of 2015 the Fed made to the U.S. Treasury to fund infrastructure projects. Other factors have been more prolonged, such as the drag on revenue growth from the soft corporate profit environment. As the middle chart shows, corporate income tax receipts have been sliding as corporate profits have weakened. A recent change in law moved the filing deadline for most corporations from March to April, making the year-ago numbers more comparable with the most recent release. Fiscal year to date, corporate income tax collections are up slightly, and the recent improvement in profits, if sustained, should aid federal revenue growth later this year.

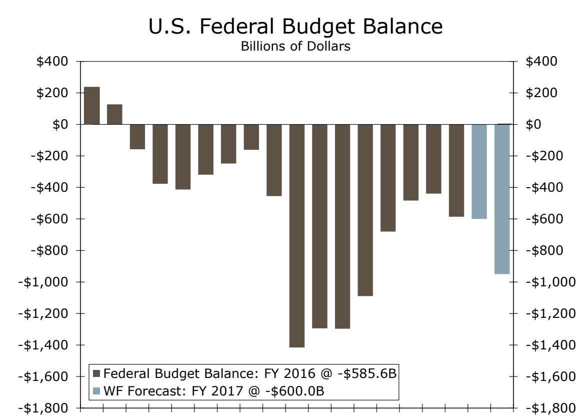
Capital gains realizations have also likely played a contributing role. As we have noted previously, the lackluster performance of equity markets in the period prior to the election likely limited capital gains realizations and the tax receipts associated with them. Between May 10, 2015 and the presidential election last fall, the S&P 500 rose just 1.2 percent. Since then, the S&P 500 has risen 12.1 percent. Despite these gains, nonwitheld individual income tax collections have still remained anemic. Perhaps at the end of last year investors chose to hold off on realizations in the hopes that the rally would continue and tax reform would be enacted this year, which could potentially provide tax relief on the gains. Withheld individual income tax receipts are up a stronger 3.9 percent fiscal year to date and should alleviate some concern about the soft headline revenue numbers.

Deficit Forecast Smaller, but Still Set to Widen from Last Year

In light of the recent budget deal to fund the federal government, we have adjusted our FY 2017 budget deficit from $650 billion to $600 billion. We have maintained since the election that the tax cuts/tax reforms proposed by the Trump administration would not affect FY 2017, and this increasingly looks like the likely outcome. Should the tax cut/reform debate become as contentious as the ACA repeal/replace effort, we would likely be inclined to trim at least some of the fiscal policy expansion currently baked into FY 2018. The next key piece of legislation we will watch closely will be the FY 2018 budget resolution, which will establish the top-line spending numbers and thus deficit targets for the next several years. The FY 2018 budget resolution will also officially get the legislative ball rolling on the tax cuts/reforms.







Source: U.S. Department of the Treasury, U.S. Department of Commerce and Wells Fargo Securities

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